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# Regulating foreign direct investment

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## *Cov. L.J. 35 Introduction

One of the more notable developments taking place in the global economy is the rise of foreign direct investment. Foreign direct investment has been described as 'a form of equity investment which gives the investing firm control over its assets, property and subsidiaries in the host country. It inevitably involves a transfer of resources, mostly in the form of capital, to enable the firm to undertake its business activities.'1 Since the Second World War, one particular form of foreign direct investment that has dominated the global economy is the multinational enterprise. There are primarily two main reasons for the rise of multinational companies. Firstly, there has been the continued liberalisation of trade that has allowed the free flow of goods, services and capital amongst nation states. This liberalisation process is now being *Cov. L.J. 36 overseen by the World Trade Organisation established as a result of the Uruguay Round negotiations in 1993. Secondly, technological changes in respect of communication and transportation have allowed the easy movement of capital from one country to another.2

Whilst multinational enterprises bring many advantages to the host country in which they invest, at the same time questions have been raised as to the accountability of such enterprises for breaches of human rights, employment rights and environmental law. In the context of developing countries, multinational companies contribute to the economic development of such countries through the transfer of technology and know how and the inward transfer of capital. However, given the power of such corporations, they generally pose a threat to the sovereignty of such countries. Control and power is usually vested in the home country where the parent company or headquarters are based and all such decisions are made there without necessarily considering the needs of the host country. In this respect, their activities are often equated with that of neo-colonialism.3 One of the major themes for those studying international business law is the regulation and accountability of multinational companies. This short article explores some of the ways in which the activities of multinational companies are regulated and the appropriateness of such methods.

## Multi-national companies and the corporate veil

Most typically a multinational company involves a parent company based in the *home* country and a subsidiary based in the *host* country. Here, the parent company will be regulated by the corporate laws of the home country and the subsidiary - being a separate legal entity - will be governed likewise by the corporate laws of the host country. Thus, a subsidiary in England would be subject to English company law. This is simply based on the premise that nation states assert jurisdiction under the territorial principle. Furthermore, a subsidiary acquires the nationality of the host country and, in line with the ruling of the International Court of Justice in the *Barcelona Traction Case,*4 would be subject to national laws of the country where it is incorporated. In this case Barcelona Traction was incorporated as a holding company in Canada in 1911. It had formed a number of subsidiary corporations under Canadian and Spanish law. After Word War I, the majority of the stock was *Cov. L.J. 37 controlled by Belgian nationals. As a result of the Spanish Civil War in 1936 the company found it very difficult to make bond payments to the bondholders. In 1948 the bond holders obtained a petition for bankruptcy and a Spanish court authorised seizure of the assets of the company. The Canadian courts refused to

recognise the validity of the bankruptcy proceedings and Canada and Belgium (along with Great Britain and the United States) commenced proceedings in the International Court of Justice alleging breaches of international law by Spain. The International Court held that Canada was the only government capable of negotiating on behalf of the corporation; and not Belgium despite the fact that a majority of the stock was controlled by Belgium nationals.

Despite the separate liability of the parent and subsidiary company, the question arises whether litigants in the host country can make the parent company liable for the acts of the subsidiary either in the home country where the parent company is incorporated or in the host country of the subsidiary. The corporate laws of many western countries adopt a legal fiction that each limited company has a separate legal identity. A corporate veil is said to exist over each separate company and the courts are generally unwilling to lift this corporate veil. This is despite the fact that in the context of multinational companies, control and power is often exercised by a parent company over a number of subsidiaries. Thus, in this context, corporate power and control is artificially protected by a corporate veil. There appear to be a number of obstacles for potential litigants who wish to make the parent company liable for the acts of the subsidiary company.

First, notwithstanding the fact that a parent acquires a separate legal identity to its subsidiary, a potential litigant may find that recourse to the parent company in the home country's jurisdiction may be ousted on the private international law principle of *forum non conveniens.* This doctrine allows a national court to decline to hear a dispute when it can be better or more conveniently heard in a foreign court. This is, perhaps, no better illustrated than by the Bhopal disaster of 1984 and the subsequent attempt by those injured by the horrific chemical disaster in the Bhopal region of India to instigate legal proceedings against a United States parent company whose subsidiary was based in India.5 In this case 2000 people died as a result of a poisonous gas leak from a chemical plant in Bhopal and over 200,000 Indian citizens ***Cov. L.J. 38** were injured by breathing in poisonous gas. Litigation was commenced in the United States by the Indian Government on behalf of injured victims. The Indian government's decision to commence proceedings in the United States was primarily based on the fact that the Indian Courts did not have jurisdiction over the Union Carbide Corporation in the United States. Union Carbide Corporation, the parent company, argued in court that the litigation in the United States should be ousted on the grounds that the courts of India were better placed to deal with the litigation. The District Court, after reviewing both public and private interests, concluded that the courts of India were the proper place for trial and judgement. Circuit Judge Mansfield explained that vital parts of the Bhopal plant, including its storage tank, monitoring instrumentation and vent gas facilities were manufactured by Indians in India. The judge explained that only a small proportion of the employees at the subsidiary were trained in the United States. Furthermore, the vast majority of material witnesses and documentary proof was based in India. The District Court dismissed the action of the Indian government on the condition that the Union Carbide Corporation submitted to the jurisdiction of the Indian courts; in 1989, the Supreme Court of India finally approved a settlement of $470 million.

In the *Bhopal* case the parent company had been required by the District Court in the United States to submit to the jurisdiction of the courts of India; too often though some countries do not require multinational companies operating in their jurisdictions to comply with all the laws of that country. Some states such as Sri Lanka have created what are known as free trade zones where multinational corporations are subject to separate law or are allowed waivers of national laws. One non-governmental organisation explains that multinational companies and governments collude so that serious breaches of human rights and labour laws go unpunished.6 In some jurisdictions it is not just corruption between governments and multinational companies that prevents access to law; in most cases it is the lack of financial or legal resources which makes access to law impossible. The net effect being that collusion produces a legal vacuum with little or no accountability.

## Making multi-nationals legally accountable

Despite the legal vacuum that exists in many host countries in the effective control of

multinational companies, there is, amongst some of the more developed nations in ***Cov. L.J. 39*** the global economy, a growing recognition that a parent company could be legally liable for the acts of its subsidiary in another jurisdiction.7 For example in the United States, actions can be initiated by foreign citizens against United States individuals under the Alien Tort Claims Act 1789. This Act allows for actions to be instigated in respect of violations of international law as well as US law. In one United States case - *Doe v. Unocal Corporation*8 - plaintiffs from the Tenasserim region of Burma brought class actions against the Burmese Government and an American oil company (Unocal) which had entered into a joint venture for the construction of a gas pipeline in Burma. The plaintiffs argued that the government and the oil company had conspired and acted in violation of international law; police and military forces had used violence in relocating whole villages as well as forcing farmers into working for the oil company. The plaintiffs alleged serious violations of international law and human rights in the form of assault, rape, forced labour and the loss of their homes and property. The District Court held that jurisdiction over the plaintiff's claims existed under the Alien Tort Claims Act 1789 and thus rejected Unocal's attempt to dismiss the claims.

In England, there is a growing recognition that a parent company may owe a duty of care to individuals in a foreign country who are injured by the acts of a subsidiary company. For example, in *Moses Fan Sithole v. Thor Chemical Holdings Ltd,*9 21 residents in South Africa commenced proceedings against Thor Chemicals Holdings Ltd for injuries suffered as a result of exposure to mercury by its subsidiary company (Thor Chemicals SA Ltd) operating in South Africa. The South African subsidiary was primarily set up because of problems with the Health and Safety Executive in England. The South African subsidiary was controlled by the Thor Chemical Holdings Ltd in England and, in particular, by the chairman Mr Cowley. The case involved the requirement of disclosure of documents and when these were duly ordered by the Court of Appeal, Thor Chemical Holdings Ltd settled out of court. Similarly, in *Lubbe v. Cape Plc (No.2)*10 the House of Lords allowed an appeal by employees employed by a subsidiary company of Cape Plc in South Africa that their multi party actions could be commenced against the parent company in England. These employees had suffered personal injury as a result of exposure to asbestos. In March 2003 an ***Cov. L.J. 40*** out of court settlement worth approximately £10m was agreed with lawyers representing the injured South Africans.

## Conclusions

Presently there are strong calls from governmental and non-governmental bodies to address the issue of regulation and social accountability of multinational companies. If this is to be truly successful there has to be both a national and international coordinated approach to the regulation of those companies. At present various international organisations have issued codes of conduct for multinational companies which seek to set minimum standards on ethical behaviour. For example, in 1976 the Organisation for Economic Cooperation and Development (OECD) adopted the OECD Guidelines for Multinational Companies. The Guidelines consist of recommendations by OECD governments to multinational companies on matters such as employment and industrial relations, human rights, the environment, information disclosure and taxation. The Guidelines address private parties such as multinational companies and not the governments of the respective countries in which they operate; but they are voluntary in nature and thus do not have the binding force of international law. A review of the Guidelines was concluded in June 2000 bringing in further changes and recommendations on corporate behaviour. The Governing Body of the International Labour Organisation adopted the Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy in 1977. Again this code of conduct lays down basic standards and requirements in relation to equality and treatment of employees, training, conditions of work and life as well as industrial relations. However, like the OECD Guidelines, the Declaration is voluntary in nature. Whilst multinational companies are more than happy to promote the use of these voluntary codes of conduct, this is primarily done as a publicity stunt rather than as part of a strategy for complete compliance.

In the absence of binding international law that can effectively control and regulate multinational companies, there is a pressing need for jurisdictions to enact legalisation which addresses the specific issue of foreign direct liability for multinationals. It is clear from past negotiations at international level that uniformity in the control of multinational companies requires all nation states to adhere to the same policy considerations. However, given the different interests of nation states, achieving such uniformity has been the biggest stumbling block to the effective international control of foreign direct investment.

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1.

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2.

For a more detailed account of the factors behind globalization of international business, see C.W.L. Hill, *Global Business* 2nd Edition (2002) McGraw Hill Irwin, Boston.

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Harrison, Dalkiran & Elsey, *International Business,* 2000, Oxford at p.48.

4.

*Case Concerning The Barcelona Traction, Light and Power Company* [1970] I.C.J. Rep.4.

5.

*In Re Union Carbide Corporation Gas Plant Disaster at Bhopal* (1987) 809 F. 2d 195 United States Court of Appeals (2d. Cir). In English law, the *forum non conveniens* rule will be applied where there is some other jurisdiction 'in which the case may be tried more suitably for the interests of all the parties and for the ends of justice,' see *Spiliada Maritime Corporation v Consulex Ltd* [1987] AC 460.

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